DOW THEORY LETTERS INC.

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Registered with the Securities Exchange Commission

40 Letters per Year — $50.00 Annually

THE MARKET: On September 8 (see Chart 1) the Industrial Average hurdled its July 17 high of 851.35. After rising in rather gingerly fashion into the 870 area, the senior Average (during most of September) elected to move sideways. On Monday (October 5) upon the news of a probable settlement of the General Motors strike, Industrials rushed up again to close at a new all-time high.

The Rail Average staged a good recovery following its August low and at this writing has managed to make up almost all of its July-August losses. But the carriers have (so far) failed to better their July 17 peak of 220.98. Although Rails have tended to move "in direction" with Industrials, they have still not confirmed the series of new Industrial highs (above the July 17 peak).

Under Dow Theory the prevailing trend (in this case, bullish) is considered to remain in force until proved otherwise. It is obvious that the Averages (representing, as they do, the sum total of investors' knowledge of the future) have been taking a hard look at the period ahead. The "all clear" signal will not be given until Rails better the 220.98 point. By halting just under their previous peak, Rails are saying that the situation could quickly turn unpleasant (and the "unpleasantness" would be apparent if the two Averages turned down — following a Rail non-confirmation). On the other hand, the Averages are also saying that with the advent of a Rail confirmation (which is certainly within very easy reach) and a continuing rise by Industrials, the situation could just as quickly take on a bullish (perhaps explosive) appearance. Adding suspense to the picture (see new composite chart on this page) is the fact that the advance-decline ratio is within a fraction of bettering its long-standing 1963 high.

The politico-economic background is as potentially explosive as the market. Currently, we see a pressing international monetary situation, a Republican Presidential campaign which started on high hopes but which (for reasons I will not go into here) is now floundering badly, a 15-year old bull market which is intent on driving the last bear to the wall, a host of professionals who are confidently waiting for the long-promised "final bull market blow-off"

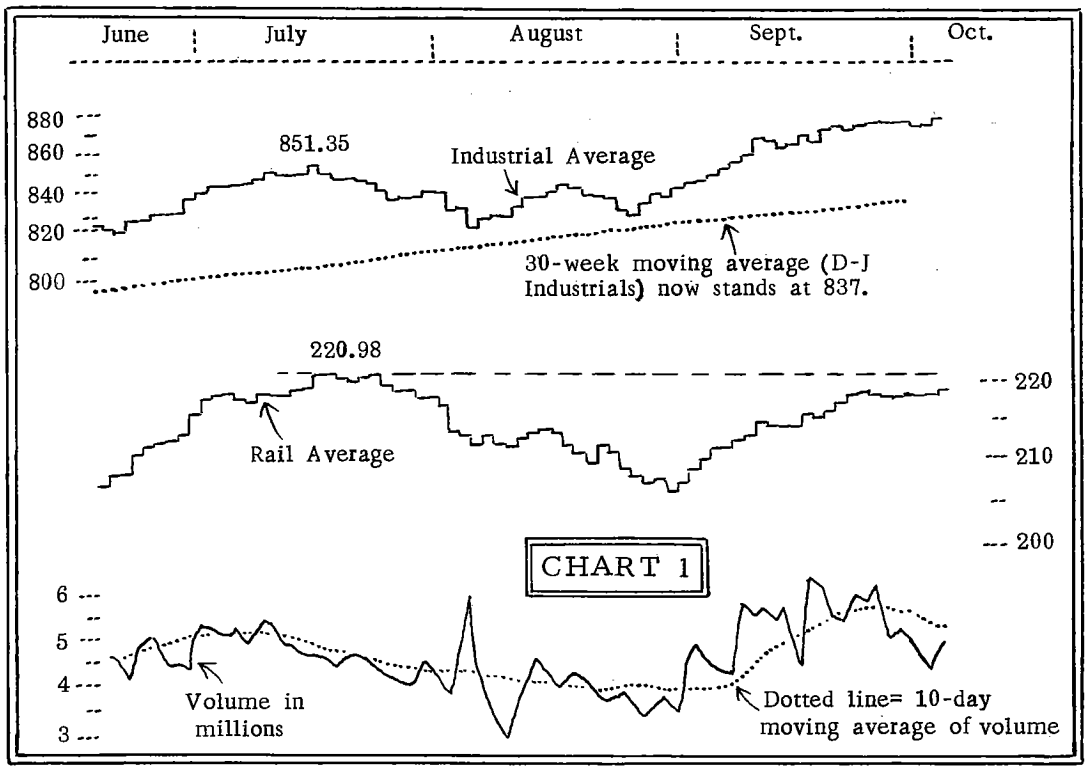
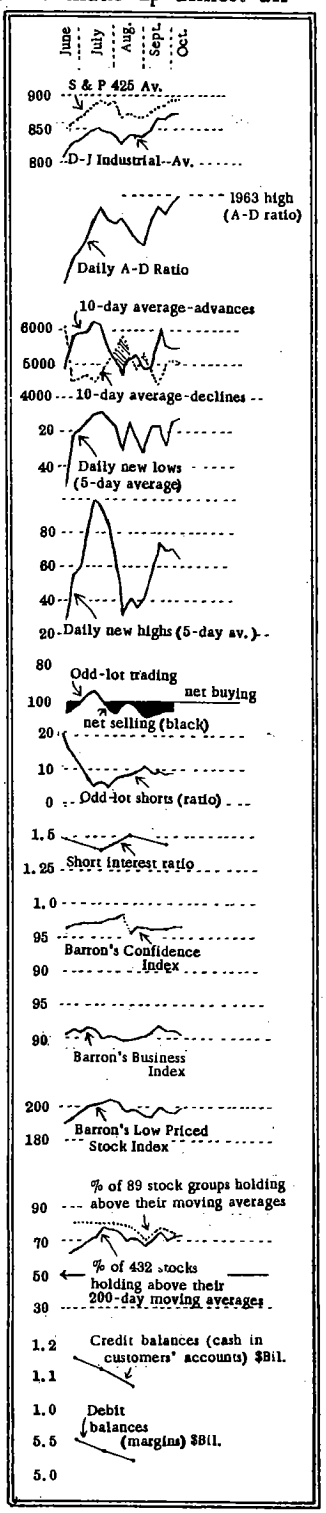


CHART 1



 (we are told that this last surge will take us "safely" into 1965), an economy which (as my friend Eliot Janeway put it) is ready to move from "boom to super-boom," a public which is deeply in debt and enjoying one of the greatest spending sprees in history (I figure that over the past three years a new car has been sold for every 8 1/2 men, women and children in America), a British election on October 15 with its serious implications for interest rates and the pound, an American election in November which (ah contrary opinion) has been preceded by some of the dullest campaigning this writer has seen. The next six months promise to provide much in the way of high drama. The irrepressible veteran market observer, Major Angus of Vermont, predicts in his latest report: "Fifty percent of my clients will lose fifty percent of their capital — within three years." One of my fondest hopes is that I can keep my subscribers on the right side of the Major's "50%."

NEW FEATURE: The writer is constantly working in an effort to provide readers with as much solid information as possible. In early 1962 I introduced a chart containing a number of averages and indicators. Unfortunately, the chart was dropped a few months later because of difficulties connected with reproduction. I have been brooding over the chart (and I have been spurred on by older subscribers to reinstate that chart) for the past two years. A new enlarged version of the 1962 graph appears in this Letter (and I hope that it will be a permanent feature of the Service). I believe the new chart will be of interest to all subscribers. As an aid to understanding the chart, and for the particular benefit of new subscribers, I have included a special descriptive (green) page with this mailing. Please save the green sheet for your future reference.

Much of the material in the new chart is self-explanatory, but I will offer periodic comments on whatever items I think are of particular interest. A friend from New York who has been consistently successful in Wall Street once told me: "The secret to success in market analysis is in knowing what indicators and facts to throw out at any given time." I happen to agree, for in the end, market analysis is an art rather than a science (it is notable that despite all the recent hard work, no one has yet been able to put the "facts" into a computer and come up with the answer).

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On September 25 the Standard & Poor "425" and "500" Averages both bettered their July 17 highs (see Letter 266), and this eliminated one major cause for technical concern. Nevertheless, the market still seems unable to produce an impressive batch of daily new highs, a phenomenon which shows up clearly on the chart (note that the 5-day average of new highs remains persistently under its July, 1964, peak of 99).

Odd-lotters cling stubbornly to daily selling balances (i.e., more sales than purchases), a situation which constitutes a continuing "plus" in the technical position of the market. The question of what the public is really doing is an exceedingly puzzling one at this time, and it is discussed in detail in the next section.

IS THE PUBLIC IN THE MARKET? The answer to this critical question is an almost unanimous "no" from Wall Street's analysts. Yet certain aspects of the total market picture do not support the thesis that the public is "on the sidelines watching the show."

The very instructive Chart 3 is from a private letter just received from Dr. Sloan Wilson (he is the foremost authority on the credit and debit balances). Chart 3 follows the path of the D-J Industrial Average and the monthly credit and debit balances over the past seven years.

The chart brings out the following striking facts: (1) Since January, 1964, there has been a steady decline in credit balances or cash in customers' accounts. The total decrease has been 14.7%, and this places credit balances at their lowest level since October, 1960. All of which certainly suggests that the cash customer (i.e., the public) has been coming into the market.
(2) Since November, 1963, there has also been a steady decline in debit balances or margin accounts. The total decrease since late-1963 has been 7.3%, and debits have now sunk to their lowest level since August, 1963.

Note the "normal" action of the cash customer (credit balances) during the market rises of 1957-59 and 1960-61. Cash customers sold during the first (and most profitable) part of the advance as seen by the rising credit balances; they then bought stocks during the second (or distributive) phase of the advance as seen by the declining cash balances (dotted line on chart).

During the same periods, the professional speculators acted as follows: they bought heavily and increased their margins through the early and most profitable part of the advance (rising debit balances). Then professionals correctly "pulled in their margins" near the ultimate market peaks as seen by the declining debit balances. Note that debits have "topped" early in the current rise (November, 1963,),